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Imperfect Liability Regimes: Individual and Corporate Issues

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IMPERFECT LIABILITY REGIMES: INDIVIDUAL AND CORPORATE ISSUES

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I. GOODBYE TO AN OLD FRIEND

It is my great honor and privilege to participate in a Symposium that is devoted to the memory of Gary Schwartz, who died this past year at far too young an age. I first met Gary in the fall of 1968. It was my very first year of teaching at the University of Southern California. Gary, who was several years ahead of me in Law School nonetheless had decided to enter the teaching market the year after I did. He interviewed that year both at the University of Southern California, where I previously taught, and at University of California, Los Angeles, where he was to teach throughout his entire professional career. From the outset, it was easy to identify those extraordinary features of mind and character that he carried with him throughout his entire professional career. Gary was totally absorbed in his work as a tort scholar. His knowledge of the tort field was encyclopedic and unrivaled. His curiosity was unquenchable. His persistence in tracking down information about particular cases and controversies was rightly legendary. All these skills he brought

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to bear in his professional work. He was always a source of good advice to me in preparing the editions of my tort case book. He was active in writing and in conferences. He showed a remarkable sense of intellectual balance and political shrewdness in the work on the *Restatement (Third) of Torts: General Principles* that he had completed just before his death.

Gary was more than learned and engaged. He brought a distinctive objectivity to his scholarship. He could never be lured into a position that was not fully supported by the evidence. He was not a man of great political passions, so his scholarship was always in the service of getting it right and never in advancing this or that partisan agenda. No matter how the evidence cut, he was always prepared to follow a trail to its end. In so doing, he displayed the ideal mix of detachment and passion in scholarship. He should remain a role model to us all. I have been much influenced by his work and miss him as the entire torts profession and legal profession should miss him as well. His interests extended from legal history to contemporary problems. I hope that what I have to say about corporate and successor liability would have met with his approval.

II. IDEALISM AND REALISM IN TORT THEORY

Before we approach the particular question of successor liability in products liability cases, we must set that problem within a broader theoretical framework for discussion. Much of what we have to say about this particular problem is a function of how we think about larger questions of tort liability. In that regard, tort law is not unique among legal areas, nor is successor liability distinct among tort topics. The initial task of the modern tort theorist is to develop some powerful model to articulate a set of optimal rules for regulating human conduct. His second task is to deal with the grubby question of proving the elements of a cause of action and collecting settlements and judgments. The hardest inquiry is one of translation, which asks how to best develop a set of discrete rules and practices that preserve as much as we can of the ideal theory, given the sand in the gears that can plague the operation of the legal system on a day-to-day basis.

These issues are apparent in dealing with suits against individual parties. Initially, I do not pay much attention to the distinction between cases of liability to strangers and liability arising out of consensual arrangements, although that distinction proves critical in the later discussion.[1] However, no matter what the particular context, all the theories of optimal deterrence presuppose, as a first approximation, that defendants are in a position to pay the judgments against them after the fact, giving them the incentive to conform their actions to the law before the fact. Most commentators quickly gravitate to either a system of negligence or one of strict liability to deal with harms to others brought about either by applying force or, of special relevance in products liability cases, creating dangerous and defective conditions. The initial step in the model is to assume that the defendant is the sole active party (or the only party whose behavior will respond to

1. *See infra* Part V.

incentives). We then must develop a theory to decide whether the liability should attach for the damage caused. The usual tension in the law gravitates between a choice of strict liability and negligence, and the conflict is hard to resolve because, as a matter of first approximation, the social consequences overall are apparently the same. Defendants will take the same level of precautions under both systems in a first-best world that ignores practical difficulties in implementing the basic legal norm.[2]

The usual drill runs as follows: Under negligence, society will not ask the defendant to pay damages when his conduct conforms to the optimal standard that the law requires of his behavior. The maxim of "no liability without fault" is lifted from the moral vocabulary of blameworthiness into functional terms. Its traditional exposition was urged by Chief Justice Nelson of New York who wrote: "No case or principle can be found, or if found can be maintained, subjecting an individual to liability for an act done without fault on his part."[3] In its new guise, the proposition comes to mean that so long as the defendant's conduct is judged efficient *ex ante*, the defendant will be insulated from liability no matter whatever untoward consequences occur *ex post*.[4] The realization of a long-shot is not allowed to alter one's *ex ante* judgment about the reasonableness of the precautions taken.

In contrast, under strict liability, the defendant will not take precautions against harm when it is cheaper to pay the (socially correct) measure of damages against him. The strict liability standard does not measure inputs but looks only to outcomes. It imposes liability on the harmful consequence and assumes that the defendant then chooses the appropriate standard of conduct subject to this constraint. Strict liability privatizes all decisions about the appropriate level of care for the plaintiff. If defendants on the ground have more reliable information about the relevant costs and benefits, then they should make better decisions in a second-best world.

However, in both cases the level of care chosen will gravitate to the point where only cost-effective precautions are undertaken. Issues become a little more complicated when, under either negligence or strict liability, the prima facie case of liability is then cut back based on defenses having to do with contributory negligence, assumption of risk, product misuse, and the like. The hope is that some combination of commands to both parties of a harmful interaction will reduce the frequency and severity of the harms in question by an amount that exceeds the cost of running the more complex system put into place.

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2. I develop this point at greater length in RICHARD A. EPSTEIN, SIMPLE RULES FOR A COMPLEX WORLD (1995).

3. Harvey v. Dunlop, Hill & Den. 193 (N.Y. Sup. Ct. 1843)

4. For its canonical exposition, see Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972); for the initial formalization of the principle, see John Prather Brown, *Toward an Economic Theory of Liability*, 2 J. LEGAL STUD. 323 (1973).

III. THE SOLVENCY AND ENFORCEMENT GAPS

Whatever conclusions we reach on these issues in a first-best world have to be tempered by the knowledge of the imperfections associated with making these rules operational. Whether the law adopts theories of negligence or strict liability, the defendant will take the right level of precaution only if he has financial resources that allow him to meet any liability against him. Otherwise, there is the danger that he will trim his actions, that is, reduce his care levels, to take into account that his liability will be limited to the pot of resources under his command no matter what the final judgment. Let the probability of an accident equal one percent and its potential liability be $100,000, then, ideally, the defendant should take precautions that cost $1,000 or less to eliminate this potential source of liability.[5] But if the defendant's wealth is only $50,000, then he will skimp on precautions because if the accident comes to pass, then he will be able to satisfy only half the judgment against him. He trades off one percent of the $50,000 in potential liability, while the correct social equilibrium calls for him to trade off one percent of $100,000. Once the plaintiff knows (if he knows anything at all) that the defendant might face this kind of gap, then presumably he will adjust his own conduct accordingly to take greater precautions than might otherwise be necessary in the case. But if the parties are not in direct privity, then other defendants may reduce their level of care because they expect that potential victims will take higher levels of care.

In light of these strategic possibilities, the happy assumption that both sides will travel to the social equilibrium is highly doubtful in practice. The situation where either or both parties labor under optimal incentives is highly unlikely. To see how this unlikelihood works, start with something as simple as an intersection collision between two drivers unknown to each other at the outset of the transaction. In this setting, the gap between the ideal precautions taken by both parties and those actually taken exists whether we use negligence or strict liability. The problem will also be acute no matter which defense regime is used to deal with the plaintiff's conduct. In some fraction of the cases, the defendant will not be able to establish any of those defenses. In others, the defense will work only to reduce and not to eliminate liability so that the solvency gap will persist whenever the defendant's share of the total anticipated loss remains below his net worth.

What then in the individual context can be used to bridge this solvency gap? The problem has multiple responses. The first response is, in a sense, the best of all because it does not involve altering legal responses to any problem. Call it *self-bonding*. When dealing with many potential tort situations, the defendant often puts himself at risk by the same conduct that places the plaintiff at risk. The paradigmatic case of a self-bonding situation is the automobile accident in which the defendant motorist typically exposes himself, his own vehicle, and his passengers to serious risks of injury or damage. A similar concern arises in athletic accidents as well. These built-in incentives to take care will obviously not work as

5. This example illustrates Judge Learned Hand's classic formula for negligence liability. *See* United States v. Carroll Towing Co., 159 F.2d 169 (2d Cir. 1947).

well with deliberate harms, where the defendant's calculation allows him to adopt a strategy to insulate himself from harm while inflicting it on another person. But for accidental harms in direct person-to-person contact, that level of planning is rarely available so that the defendant will internalize some fraction of the losses, even if he escapes detection and is insolvent. Self-bonding creates an incentive outside the tort system for people to be careful, which, in many cases, is more powerful than the possibility of tort liability itself. This set of sanctions does *not* kick into most products liability cases because the defendant has parted possession with the product in question, which almost always causes harm after it leaves the defendant's possession and is in the hands of the plaintiff or some third party. One reason, presumptively, for tougher liability rules against defendants in products liability cases than in intersection collision cases is that an important extrajudicial system of restraint does not operate on the defendant.[6]

Next, the legal system responds to the gaps in incentives under the system of tort liability by going outside its boundaries, namely, by using direct regulatory mechanisms that might otherwise prove to be redundant or unimportant. Thus, many automobile drivers will decide to heed the traffic laws because they run the risk of fines or loss of license. These sanctions do not normally require some accident to trigger them. Indeed, their ubiquity is precisely what makes them so effective in dealing with dangerous forms of conduct that pose threats to large numbers of unidentified people. The possibility of losing a driver's license leads people of limited resources to curb their behaviors in ways that reduce the probability of accidents. My own casual empiricism suggests that most people are more worried about losing their driver's license or about police enforcing the speed limit than they are about the potential standard of tort liability if an accident occurs. Certainly, they have better knowledge that the police are cracking down than of any shift in the burden of proof on contributory negligence.

Regulating dangerous products also raises similar questions of the integration between self-bonding, tort, and the regulatory systems. Self-bonding tends to play no real role here because, for products liability to attach, products are by definition out of the defendant's control. So, the relevant trade-offs are between liability and regulation. Here, the balance is somewhat more complicated, as will become evident in a moment. Larger companies have ample assets to meet tort liability while smaller innovators do not. Yet, the overall regulatory schemes, such as those mandated by the Food and Drug Administration or the National Highway and Traffic Safety Act, apply to both large firms and small ones. In these cases, both forms of loss exposure are likely to prove critical, but their relative weights may vary by the level of assets and the kind of products that are in issue. Some regulatory changes are costly to implement, but do little to stave off tort liability. In other instances, the risk of tort liability is so great that firms would eagerly accept more stringent regulation in order to stave off the liability risk. In that last category, we can be confident that most drug manufacturers would agree to

6. The matter is muddied because in many cases a second set of constraints is operative in product cases, but not individual liability cases, namely the *reputational* losses to the firm.

virtually any set of warnings if they knew in advance that compliance with the statutory command would defeat a products liability action. The same can be said with respect to design defect liability in the automobile context.

Third, we have the common practice, often mandated, of requiring individuals to purchase liability insurance for certain activities that are likely to prove dangerous.[7] Here again, automobile insurance is the most obvious candidate, but homeowner's and professional liability insurance are also critical. The purchase of insurance creates a dilemma that is easy to state but impossible to solve: the insured defendant may be more likely to engage in activities that cause harm precisely because he is aware that someone else will be there to foot the bill for defense costs and liability once those losses happen. Alternatively, ordinary first-party insurance could erode the self-bonding features of individual behavior, which was evidently the case in the *locus classicus* of negligence cases, *Vaughn v. Menlove*,[8] where the defendant was quite happy to engage in risky conduct because he knew that his cattle were insured.[9] To deal with this question, insurers often insist on terms that preserve their right to cancel coverage in the event of certain dangerous behavior by the individual insured, *e.g.*, deliberate harms. At this point, insurance has to be understood in the context of other systems of social control, so that in an odd sense the insurance system then picks up those cases where the criminal law system does not intervene. Even in those cases, the insurance contract may contain various deductibles and exclusions that impose some residual liability on the insured, such that the sting of financial liability is not altogether extinguished.

Fourth, we have elaborate rules of vicarious liability that hold other individuals responsible for the wrongs of some tortfeasors. In some cases, the parties who are held vicariously liable are individuals who themselves may be less-than-ideal candidates for tort defendants. We see this result with any ordinary agency situation. But in many cases the defendant subject to vicarious liability is a corporation that has both deep pockets on the one hand and limited liability on the other.[10] The existence of this corporate liability (and in some cases the insurance to cover it) creates additional incentives on the immediate actors to observe a higher level of care—they now face sanctions such as losing their job, which they would rather avoid. It also imposes on the employer a powerful incentive to select and train people for positions within their organization with a view toward avoiding the employer's own potential liabilities. Thus, even when an action for indemnification

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7. *See* Gary T. Schwartz, *The Ethics and the Economics of Tort Liability Insurance*, 75 CORNELL L. REV. 313 (1990).

8. 132 Eng. Rep. 490 (C.P. 1837).

9. *Id.* The defendant set a hayrick, which was known to have a high risk of spontaneous combustion, by the boundary of his land. *Id.* at 491. When asked to take down the rick, he said that "he would chance it" because his own stock was insured. The court found liability, of course, and Judge Park was sufficiently nonplused to write "there is no colour for altering the verdict, unless it were to increase the damages." *Id.* at 494.

10. *See, e.g.*, Alan Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231 (1984) (discussing a variety of forms of vicarious liability and their economic implications).

against the immediate tortfeasor is of little value, the entire system continues to work better than it would in a world of individual liability only.

IV. CORPORATE AND SUCCESSOR LIABILITY

This symposium is not, however, devoted to the odd imperfections of the tort system as it applies to individual defendants, but instead to those that apply in products liability cases. Here, the defendants in question are almost always corporations, partnerships, or other forms of business. The substantive law has long held that "casual sales" are outside the scope of products liability law;[11]they are covered by more general principles of tort law that do not impose the "special liability" that dominates this field.[12] I will not discuss how these sales relate to successor liability. Therefore, to frame the question of successor liability more clearly, the threshold question becomes: What should be done with tortious liability for corporate entities in the first place?

In many cases with large public corporations, tort liability is just not a problem at all. As a global matter, the corporate feature of limited liability that insulates individuals' personal fortune from the fate of the firm paradoxically *reduces* the insolvency risk that so frequently threatens the sound administration of tort law. In an economic sense, limited liability functions to get unconnected individuals to invest in a business, knowing that their liability will be equal only to their past investment plus any future contributions that they obligate themselves to make. Armed with that knowledge, investors are more willing to pool their resources with other like-minded individuals of whose business acumen they have little, if any, personal knowledge. The shares that they receive are transferable as a matter of law, and a ready market can often be created for these shares for two reasons. First, the shares are fungible, so that one is a perfect substitute for the next. Second, the buyer takes the shares with the same limited liability protections of the seller. In practice, the shares of a close corporation may often be difficult to sell, for outsiders are rarely eager to assume the position of minority outsiders in a close corporation. But with large publicly held corporations, these restraints do not apply.

Also, the condition of potential tort creditors to the publicly-held corporation is further improved because no creditor of the individual shareholder can reach the corporate assets to satisfy personal debts.[13] Rather, the individual shareholder's

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11. RESTATEMENT (SECOND) OF TORT, § 402A, cmt. f (1965) [hereinafter SECOND RESTATEMENT]; RESTATEMENT (THIRD) OF TORTS: PRODUCT LIABILITY, § 1, cmt. c. (1998) [hereinafter PRODUCTS LIABILITY RESTATEMENT].

12. See SECOND RESTATEMENT, § 402A, which uses that term in its heading for its critical strict liability provision—Special Liability of Seller of Product for Physical Harm to User or Consumer—which with the passage of time swept away the general heading of negligence liability in many cases. For a perceptive discussion of the relationship between negligence and strict liability, see Gary T. Schwartz, *The Vitality of Negligence and the Ethics of Strict Liability*, 15 GA. L. REV. 963 (1981).

13. *See* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000) (discussing affirmative and defensive asset partitioning).

creditors simply become transferees of the shares and can sell the shares for ready cash to satisfy their claims. The upshot of this structure is that large aggregations of capital can be brought together under a single roof. Limited liability for an asset-rich corporation leaves the tort claimant with far more wealth to shoot at than unlimited liability of individuals who would otherwise be reluctant to enter into any joint venture in the first place. Moreover, corporations do have long term interests in brand maintenance, which backstops the basic system of tort liability. As a first approximation, corporate limited liability should increase the odds of recovery by the random tort plaintiff. At crunch time, would most plaintiffs rather be injured by the product of some large corporation or some casual interaction with a private individual of limited means?

However, in some specific contexts corporate liability raises a very different specter. Certain small businesses will incorporate not to pool the capital of separate individuals but to limit their exposure to tort liability. The contract claimant worries less about corporate limited liability because he can usually insist that key shareholders sign individual guarantees that cover defaults that might occur if, for example, assets are drained from the corporation in advance of tort liability. But tort claimants are in a far more vulnerable position because they are unable to negotiate these *ex ante* guarantees. An ordinary business can parcel its assets among different corporate shells in the effort to insulate the bulk of the business from the misdeeds of any single component. The liability for fleet owners of taxicabs who secrete each cab in a separate company illustrates this problem. This ruse works so long as each corporate entity takes out the requisite level of mandated insurance and takes care not to conflate the day-to-day activities of the operating entities nor commingle their funds.[14]

The clear view in this case is that the legislature can and should set the minimum level of tort protection to be supplied by each firm. If the legislature is willing to allow ordinary drivers on the highway with minimal liability coverage, then what grounds are there to cavil if the situation is made a little bit better by imposing a mandatory insurance requirement on a small corporation of convenience? The remedy in these cases is not to allow the tort claimant to pierce the corporate veil (at which point these enterprises could easily cease), but to stipulate that the level of insurance has to be greater to meet these perils. Increasing that insurance requirement would have the further desirable effect of creating a *separate fund* that only tort claimants can access, thereby solving the problem of priority that could easily arise when tort and contract creditors are busily pursuing overlapping claims against the same pool of assets. Contract beneficiaries are the sole persons who can chase after the individual guarantors; tort creditors are the sole persons who can chase after the separate insurance fund.

No one argues about the legitimacy, in principle, of any state requirement to carry tort insurance that meets the claims generated by the business, whether it be for intersection collisions or for product damages. The only interesting question here relates to the choice of baseline for the optimal level of damages. Should it be

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14. Walkovszky v. Carlton, 223 N.E.2d 6 (N.Y. 1966).

the same as that for individual drivers, or should some corporate premium be incorporated into the mix? On that question reasonable minds could differ, and my own tentative view is that some golden median between the two extremes is usually the best we can hope for. To set the levels of required insurance too high is a risky strategy, but not so much because individuals and firms will choose to abstain from dangerous activities because they cannot secure the cover. Rather, the risk comes from other quarters: either firms will continue to engage in risky activities without purchasing any insurance protection at all or individuals will simply not incorporate and do business in the first place.

V. THE TORT/CONTRACT LINE REVISITED

Piercing the veil can arise in products liability cases and inject at least two distinctive issues. The first issue questions whether product claimants should be treated as tort claimants at all. An initial line of cases involves *stranger* cases where there is no web of contracts that links the injured party to the injurer prior to the inception of the law suit.[15] Products liability cases are often treated as stranger cases to which tort rules apply. For example, in connection with efforts to reach a parent corporation, Judge Pointer wrote in In re *Silicone Gel Breast Implants Products Liability Litigation*:[16]

> A rational distinction can be drawn between tort and contract cases. In actions based on contract, "the creditor has willingly transacted business with the subsidiary" although it could have insisted on assurances that would make the parent also responsible. In a tort situation, however, the injured party had no such choice; the limitations on corporate liability were, from its standpoint, fortuitous and non-consensual.[17]

I find little reason to doubt the systematic force of this distinction. But I seriously question whether under this test we can characterize products liability cases as tort suits, at least those that involve suits by users and consumers. To be sure, physical harm may not occur to a person who is in privity with the defendant manufacturer. After all, distributors and retailers are all active in the chain of distribution. Even though the usual products liability claimant is not in privity with the manufacturer (except in the unusual bystander cases) he is not a total stranger either, for a web of contracts still connects the two parties. The existence of this contractual chain means that the plaintiffs in question might, at least in principle,

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15. I have pushed this line most aggressively. *See, e.g.*, Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151 (1973) (analyzing the conflict between negligence and strict liability theories); Richard A. Epstein, *Medical Malpractice: The Case for Contract*, AM. BAR. FOUND. RES. J. 87 (1976) (discussing tort and contract law within the medical malpractice context).

16. 887 F. Supp. 1447 (N.D. Ala. 1995).

17. *Id.* at 1453 (citations omitted).

choose the company from which they purchase based on its willingness to bear liability for its losses. Hence, it becomes possible to treat these "creditors for physical injury" as contract and not tort creditors.

To be sure, today we see *no* evidence of remote defendants offering to assume liability to the parties they might potentially injure. But in theory that hardly proves the absence of a contractual link - the seller of an automobile or a prescription drug on its own initiative could designate its immediate sellers as its agents to negotiate the contractual terms on which damage payments will be supplied for physical injury. Alternatively, if connecting with intermediates is difficult (as in the case of some users), a firm could publicly announce the terms and conditions under which its product is sold, which should bind any persons who choose to use the product thereafter. One possibility is that the protection could be offered to those who buy the product with knowledge of the condition in question, on the model of the old smoke-ball case.[18] But in these circumstances, I see no reason why a firm could not oblige itself to make the additional compensation available to anyone who has injured himself, whether or not that offer was accepted prior to the time of injury. So long as the firm has the power to define the scope of its own obligations, it should be able to waive the knowledge requirement, just as it should be allowed to do in the reward cases, if it so chose.[19]

The obvious retort to these proposals for creating contractual ties is one of dismissive skepticism, which in this case is misplaced for several reasons. First, manufacturers today do not have the power to stipulate whether they are in or out of the products liability regime. The key consequence of the crucial early decisions in *Henningsen v. Bloomfield Motors, Inc.*[20] and *Greenman v. Yuba Power Products, Inc.*[21] was to undermine any and all manufacturer efforts to *limit* liability by contract.[22] Thus, creating a limited liability regime in which the manufacturer would stipulate, direct to the purchaser, a willingness to repair or replace the product sold could not operate to eliminate full tort liability for any personal injury that arose from the use of the product.[23] Moreover, in some cases, attempts to create some limited liability that went above and beyond what the tort law required were

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18. *See* Carlill v. Carbolic Smoke Ball Co., 2 Q.B. 484 (1892) (concerning a vendor of a medical product offering a "reward" to anyone who contracts a specified disease after using the product).

19. The doctrinal position is often otherwise. *See, e.g.*, Fitch v. Snedaker, 38 N.Y. 248 (1868) (requiring knowledge of offer to work an acceptance). But so long as the firm can specify the conditions under which the payments are made, where lies the risk? If it is concerned, it can cap total liability or attach any conditions that it sees fit.

20. 161 A.2d 69 (N.J. 1960).

21. 377 P.2d 897 (Cal. 1963).

22. "[T]he liability is not assumed by agreement but imposed by law, and the refusal to permit the manufacturer to define the scope of its own responsibility for defective products make[s] clear that the liability is not one governed by the law of contract warranties but by the law of strict liability in tort." *Id.* at 901 (citations omitted). *See also* SECOND RESTATEMENT, *supra* note 10, at § 402 cmt. m.

23. *See, e.g.*, *Henningsen*, 161 A.2d at 80 ("[I]t may be said that the express warranty against defective parts and workmanship is not inconsistent with an implied warranty of merchantability. Such warranty cannot be excluded for that reason.").

met with a hostile judicial response that preserved the broader scope of liability but eliminated any firm effort to limit liability.

In this regard, one key decision that has all but destroyed contractual initiatives on products liability is *Collins v. Uniroyal, Inc.*[24] In that decision, the defendant had offered a broad product warranty whose coverage extended to all "blowouts, cuts, bruises, and similar injury rendering the tire unserviceable," without any proof of product defect, so long as the tire was not "punctured or abused"—a clause designed to guard against moral hazard by the product user.[25] The provision then excluded all liability for consequential damages, but obliged the tire company to repair or replace the tire.[26] This provision is in perfect accord with general business practices that exclude consequential damages at every conceivable opportunity on the simple rationale that the individuals who wish to recover these damages *ex post* do not wish to pay *ex ante* an embedded premium equal to their full cost.[27]

In *Collins*, the court rejects the limitation against consequential damages under New Jersey's codification of the Uniform Commercial Code, which provides that: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."[28] Arguably, this initial presumption against limitations on consequential damages could be overcome in *Collins* because it was attached to an *extension* of liability that was not required in the first place. We now have a corporate double. *Henningsen* and its progeny make it impossible to limit tort liability; *Collins* and its progeny make it impossible to expand liability incrementally. The contract market in warranty terms has been killed by the legal regime.[29]

This chilly response to contractual limitations on tort liability has had vital ramifications for the patterns of corporate investment. Suppose that any corporation had its full set of contractual options to either limit or expand at will. At this point, the firm has no incentive whatsoever to rely on the corporate limited liability rules to reduce its exposure to tort liability. The contracts can achieve that objective with far more precision because they can set out the liability limits in each individual case and not rely on a crude overall limitation that is geared only to overall potential liability, instead of potential exposure to any individual claim. If the markets work at all efficiently, then this regime should serve to maximize the *ex*

24. 315 A.2d 16 (N.J. 1974).

25. *Id.* at 19.

26. *Id.*

27. For one recent explanation of this position, see the powerful opinions of Judge Easterbrook in *ProCD v. Zeidenberg, Inc.*, 86 F.3d 1447 (7th Cir. 1996), and *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir.), *cert. denied*, 522 U.S. 808 (1997), in the context of consequential damages for failures of computer software. For my general views on limitations of consequential damages, see Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 18 J. LEGAL STUD. 105 (1989)

28. *Collins*, 315 A.2d at 18. *See* N.J. STAT. ANN. § 12A:2-719(3) (West 1962).

29. *See* Note, *Presumptions of Unconscionability and Nondefective Products Under the Uniform Commercial Code*, 50 N.Y.U. L.REV. 148, 174-76 (1975).

ante wealth of both parties to it, which is measured not solely by the amount of *ex post* damages, conditional on injury, but also depends on the availability of newer products at lower prices. The question of corporate and, hence, corporate successor liability would be short-circuited by the contractual overlays.

VI. PIERCING THE CORPORATE VEIL

The current situation is quite different. Now that the contract solution is dead, everything turns on the scope of corporate liability. Even before we reach the question of successor liability, two trends seem clear. First, the tendency of entrepreneurs as such will be to place risky ventures in smallish corporations so that limited liability defines investor exposure when contractual limitations fail.[30] Yet at the same time, plaintiffs will make serious efforts to pierce the corporate veil to gain access to either the individual investors or the corporate parents that run the incorporated business. In these cases, the principles of liability today revolve, in products cases and elsewhere, around two rival theories.[31] First, plaintiffs try to show that the parent corporation or individual owners exerted powerful control over the day-to-day operations, so that the veil should be pierced, just as in the taxi cab cases.[32] Second, using estoppel principles, aggrieved plaintiffs will seek to show that they thought they did business with the entire entity and not just the smaller corporate component that transacted with them.[33] Both of these theories raise complex questions of proof and perception and, thus, are more costly and uncertain in their operation than the direct contractual solutions noted above.

These liability considerations make it difficult for any large corporation to enter into any ventures to develop new and risky products through related corporate entities. Once the use of subsidiary firms becomes riskier, two strategies become possible. One is to bring the entire matter in-house, assuming greater control over the total situation and giving up all efforts to minimize future liabilities by resort to the subsidiary corporate form. At this point the problem of limited or successor liability disappears. A second alternative is at least as plausible: have all dangerous new ventures started by independent start-up firms that obtain capital from venture capitalists and other unrelated sources. This total separation means that the larger corporations will get involved in distributing these products only after the risk of injury has shrunk. At the same time, this cautious strategy could harm the overall position of consumer welfare if the withdrawal of large firms means that new research is done by smaller companies with a weaker knowledge base and less experienced personnel. That risk could, of course, be reduced by entering into

30. *See* Steven N. Wiggins & Al H. Ringleb, *Adverse Selection and Long-Term Hazards: The Choice Between Contract and Mandatory Liability Rules*, 21 J. LEGAL STUD. 189 (1992).

31. *See, e.g.*, Petrovich v. Share Health Plan of Ill., Inc., 719 N.E.2d 756 (Ill. 1999) (discussing apparent and applied authority in finding that an HMO can be held liable for it's physicians' misconduct).

32. *See supra* note 14 and accompanying text.

33. *See, e.g.*, Hardy v. Brantley, 471 So.2d 358 (Miss. 1985) (holding that hospital operating an emergency room may be held liable vicariously or under theory of *respondeat superior*).

cooperative arrangements with other firms that do have greater know-how or experience, but only if they are prepared to run the risk of being held jointly liable for whatever mishaps do occur.

Once again, the social utility of piercing the corporate veil is not measured simply by the perceived desirability of having responsibility for adverse consequences *ex post*. We must assess the shifts in strategies that will be adopted *ex ante*. How this plays out is never clear in the abstract. If, however, the presumption of freedom of contract is correct in these cases, as I think it is, then the initial estimate should be that the refusal to allow contractual specifications of liability reduces consumer welfare, even if the firms can find some refuge in the corporate doctrines of limited liability.

VII. SELLING A LONG-TERM BUSINESS

The question of contract and limited corporate liability does not come into play solely with respect to the initial organization of some venture. It also affects the subsequent decisions about whether these ventures should be retained or sold. Thus, suppose that a new corporation enters into a line of business that has proven quite lucrative in the long run. Although the basic instinct may be that serious troubles will manifest themselves quickly, that instinct has proven only partially correct. For example, the manufacturer of foodstuffs may suffer a large number of small short-term claims for leaving tin slivers inside tuna cans, but as experience with asbestos, Agent Orange, and DES has shown, long-lived products could turn up major liability exposures years after they have been placed in the stream of commerce.[34]

What then should be done when business conditions appear to call for selling one of these long-term businesses? At this point, one structural alternative is for legislatures to pass statutes of repose under which all liability ceases some fixed number of years after the product is sold.[35] Such strong statutes should have the effect of increasing the transferability of corporate businesses, much like a set of binding contractual limitations. Many states have passed products liability statutes of repose,[36] and Congress has passed one such statute for aircraft sold for general

34. *See, e.g.*, Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp., 73 F.3d 1178 (2d Cir. 1995) (involving insurance claims of company faced with approximately 100,000 claimants seeking damages for asbestos exposure since 1972); *In re* DES Cases, 789 F. Supp. 552 (E.D.N.Y. 1992) (recognizing millions of pregnant women ingested DES in the 1950s and 1960s and litigation has occupied the courts since the mid-1970s); *In re* "Agent Orange" Prods. Liab. Litig., 506 F. Supp. 762 (E.D.N.Y. 1980) (involving claims by Vietnam War veterans and their families from exposure to Agent Orange during the war).

35. For a summary of such statutes, see 2 DAVID G. OWEN, M. STUART MADDEN & MARY J. DAVIS, MADDEN & OWEN ON PRODUCTS LIABILITY § 31:9 (3d ed. 2000) [hereinafter MADDEN & OWEN ON PRODUCTS LIABILITY]. Often the statutes fall short of that outcome. "Typically such statutes have 8-12 year limits, after which the injured party is barred from suing, confronts an enhanced evidentiary burden, or can recover only on proof of fault." *Id.* at 1066.

36. 2 Prod. Liab. Rep. (CCH) ¶ 3100 (2001); *see, e.g.*, 735 ILL. COMP. STAT. ANN. 5/13-213 (West 2001) (containing Illinois's products liability statute of repose).

aviation.[37] But for the most part legislatures and courts fiercely resist adopting statutes of repose with respect to the classic forms of long-term risk, such as the cumulative trauma cases, including those for asbestos and drug related conditions.[38]

Another obvious solution is to take the corporation in question and sell its shares to another firm or individuals. Within the ordinary rules of successor liability, the liabilities of the firm remain just what they were, no more and no less, notwithstanding the one-hundred percent turnover in the shareholders of the corporation.[39] That result should hold whether the shares in question were sold piecemeal or in one coordinated transaction. However, the key decision is often made after the sale, sometimes long afterwards. As a business matter, a new parent may find operating the newly acquired business as a division of a single corporation and not as a separate legal entity is cheaper and more efficient in the short-run. Ideally, that judgment should not be distorted one way or the other by imposing tortious liability to third persons. Yet, just that result can happen under the general rule today whereby liquidating a subsidiary imposes full liability on the surviving corporation—one that reaches for assets that have derived from other sources, just as if there had been a merger or consolidation of the two firms at the outset.[40] Thus, if a small company manufactured lead paint in the 1930s, and it has been taken over and liquidated one or more times since its operations, then all the assets of all the liquidating corporations stand to answer the liability for the initial small company. As such, we have the inverse situation to one in which the corporate form limits the liability in question.

In my view, the only proper response to these cases is to devise a rule in which liquidating the subsidiary firm does not expose the unrelated assets of the liquidating corporation to any tort losses of the acquired corporation. Instead, what should happen is that liability should descend only to the extent of the liquidated firm's assets (including, of course, any insurance) that have gone through the transfer. The real question then becomes how to compute that asset base. The acquired entity could either thrive or be slowly shut down, and one possibility for computing the asset base is to try to trace the entity's growth or contraction in the hands of the successor corporation. That assessment depends so much on how an integrated operation is conducted that trying to pull out one set of threads from a complex tapestry seems hopeless. The alternative view is to value those assets at the time of the liquidation of the subsidiary, and then use that figure, augmented by some standardized rate of return on assets, to calibrate the extent of the liability of the surviving corporation. Yet, even here the calculations are difficult. The initial business, if it had been a stand-alone corporation, would have doubtlessly declared some dividends from its earnings. It might have lost money on risky ventures.

37. *See* General Aviation Revitalization Act of 1994, 49 U.S.C.A. § 40101 (1997) (providing an eighteen-year repose period, subject to some exceptions).

38. *See, e.g.*, IND. CODE ANN. § 34-20-3-2 (West 2001) (providing an exception from statute of repose for asbestos cases).

39. *See* MADDEN & OWEN ON PRODUCTS LIABILITY, *supra* note 35, at § 19.6.

40. *See* 15 WILLIAM MEADE FLETCHER ET AL., CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122 (perm. ed. rev. vol. 1990).

These tort actions often are brought 40 and 50 years after the initial events, and the relentless expansion of the available asset base under any interest formula seems all too generous to potential tort claimants. On reflection, therefore, having a rule that limits the successor liability to some multiple, say 5 or 10-fold of the transferred assets seems sensible. But the entire matter is shrouded in difficulty.

Evidently all of these proposals carry with them serious difficulties of administration that are avoided by the current rule, which forces all the assets of the giant corporation to stand behind the wrongs of the liquidated subsidiary. That result looks attractive in the *ex post* state of the world, but its incentive effects are perverse. It will encourage preserving the separate subsidiary even if business purposes are thereby thwarted by the decision. Or in the alternative, it will induce firms *not* to acquire subsidiaries, knowing that, thereafter, they will not be able to deal freely with their assets. A rule that limits the liability to (some multiple of) assets descended should go a long way toward tempering that risk.

VIII. SUCCESSOR LIABILITY

We come at last to the question that has most concerned the literature: When should the law hold a successor corporation liable for the wrongs of its predecessors in title?[41] The basic problem is well set out by Richard Cupp, who writes as follows:

> Imagine, for example, that Corporation Alpha manufactures a defective product it markets as 'the Alpha ladder.' Years later Alpha sells all of its assets and the rights to its 'Alpha ladder' name to Corporation Beta for cash. Alpha then dissolves, and Beta continues Alpha's product line and business operations virtually uninterrupted by the sale. Beta continues to call the product 'Alpha ladders,' and it solicits Alpha's customers. The product is identical and the average consumer has no way of knowing that the corporate identity has changed. Beta also hires the same employees that worked for Alpha and utilizes the same equipment, inventory, design, and manufacturing facilities. Later, a consumer is injured by one of the defective 'Alpha ladders' sold by Alpha before Beta bought its assets.[42]

As an initial matter, why impose liability on Beta? The average consumer likely has no way to tell whether the old corporation has vanished and a new one has taken its place, but clearly Beta in no way made any representations when the consumer entered into a transaction with Alpha before Beta bought the assets. Likewise, the decision of the board and officers of Beta to hire Alpha's employees

41. My views are more briefly set out in RICHARD A. EPSTEIN, TORTS, §16.5 (1999).

42. Richard L. Cupp Jr., *Redesigning Successor Liability*, 1999 U. ILL. L. REV. 845, 846-47 (citations omitted). The example is loosely based on *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977). For a general overview of the topic, see MADDEN & OWEN ON PRODUCTS LIABILITY, *supra* note 35, at § 19.6.

did not create any false impression to the prior purchaser. Nor does it matter that Beta Corporation solicits Alpha's former customers, for it will surely be held liable for harms that grow out of its own connections with them. The traditional law on this point, not surprisingly, declines to impose successor liability on Beta Corporation.[43] To this general rule there are four exceptions, which run as follows:

> (1) The successor's acquisition of the predecessor was accompanied by an agreement for the successor to assume such liability;
> (2) The acquisition resulted from a fraudulent conveyance to escape liability for the debts or liabilities of the predecessor;
> (3) The acquisition constituted a consolidation or merger with the predecessor; or
> (4) The acquisition resulted in the successor becoming a mere continuation of the predecessor.[44]

Each of these standard exceptions merits a brief comment. The first is nonproblematic. The successor that voluntarily assumes liability should be held to its commitment, no matter what the nature of the underlying obligation. In the products liability context, this voluntary assumption of liability suggests that the firm believes that the additional cost of potential liability will enable it to continue to reap the good will associated with the former venture; so long as the former is greater than the latter, the transaction can take place where some of the purchase price is redirected from the selling shareholders to the insurer. In these cases, the private and social incentives are perfectly aligned, and no technical objection—some particular customer was ignorant of the assumption, for example—should be able to bind.

The second exception also makes perfect sense under the general principles of corporate law. Conveyances to defeat or delay the claims of creditors have never been sanctioned in other contexts and should not be sanctioned here.

The third exception is, for the reasons stated above, the most explosive, for it requires the surviving corporation to place at risk assets that were acquired from some independent source. This exception operates as a strong reason to discourage the merger or consolidation in the first place, even if otherwise beneficial from a business point of view.

The fourth exception is little more than a variation on the second. A business that liquidates and reincorporates solely to eliminate its tort liability has engaged in a sham transaction in marked contrast to one in which the assets are sold to a third person in an arm's-length transaction.

One key question under the law is whether the law should go any further than these four exceptions. Professor Cupp takes the view that the court should follow

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43. *See, e.g., Ray*, 560 P.2d at 8 (applying general rule).

44. *See* PRODUCTS LIABILITY RESTATEMENT, *supra* note 11, § 12; Leannais v. Cincinnati, Inc., 565 F.2d 437, 439 (7th Cir. 1977); Cupp, *supra* note 42, at 847.

the (growing) minority of cases that take one of two less restrictive positions on successor liability.[45] To use the example above, one rule would allow suit by individuals who are injured by the Alpha Corporation to bring their claims against the Beta Corporation after the asset sale, given the "continuity of management, personnel, assets, facilities, and operations, [and] whether the predecessor dissolves as soon as practicable."[46] In essence, the position here is that the liability continues to the successor when the old business is purchased as a going concern, but not otherwise. A second, even less restrictive approach imposes liability on the successor who purchases the assets of the old corporation even if he does not continue the business in full, so long as it markets the older product line uninterrupted.[47] One argument here is that the appearance of continuation is sufficient to attract the liability in question.[48]

Why, then, impose liability? At root, this question is yet another of the constant questions about trade-offs in a second-best world. Ideally, we would hope that the predecessor corporation would be in a position to bear all the liabilities associated with the sale and continued servicing of the products that it first placed out in the marketplace. The real question is: What instrumental strategies will help to achieve that result once the firm exits the scene? The argument in favor of the restricted liability is well stated in the *Restatement (Third) of Torts: Products Liability*: "[T]he general rule of nonliability derives primarily from the law governing corporations, which favors the free alienability of corporate assets and limits shareholders' exposures to liability in order to facilitate the formation and investment of capital."[49]

On the other side, the argument in favor of extended success or liability is that it will "channel back" the liability to the predecessor in title.[50] As stated by Professor Cupp, "Arguably the best justification for imposing relatively unrestrictive successor liability—that it ultimately forces the costs of defective product injuries back onto the predecessor corporations responsible for making the products—has been overlooked by many courts."[51] The successor that knows it is bound by the sins of the predecessor has greater incentives to examine the predecessor's book of business, such that the two parties will arrange for insurance coverage that protects both of them, making appropriate adjustments in the purchase price. Commentators suggest that this proposal may well work when a small under-capitalized firm chooses to sell out to a larger corporation in ways that allow it to avoid all liability for its pre-sale risks.[52] However, the difficulty with this

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45. Cupp, *supra* note 42, at 895.
46. *Id.* at 848.
47. *Id.* at 849-50.
48. *Id.* at 859.
49. PRODUCTS LIABILITY RESTATEMENT, *supra* note 11, §12, cmt. a.
50. Cupp, *supra* note 42, at 858-67.
51. *Id.*.at 860.
52. *See* Alan Schwartz, *Products Liability, Corporate Structure, and Bankruptcy: Toxic Substances and the Remote Risk Relationship*, 14 J. LEGAL STUD. 689 (1985); Robert D. Cooter, *Defective Warnings, Remote Causes, and Bankruptcy: Comment on Schwartz*, 14 J. LEGAL STUD. 737,

argument is that it presupposes that the only effect of the proposed regime of successor liability is to alter the terms of sale between the predecessor and the successor.

On balance, the Restatement position has the better of this exchange. What is overlooked in Professor Cupp's channeling argument is the possibility that the increased liability will result in scrubbing the transaction. That result could happen, for example, if the value of the business as a going concern were ten million dollars, while its potential liabilities were, say, twelve million dollars. At this point, the sale would not take place because the insurance coverage would require the seller to pay two million dollars for the buyer to assume the liabilities. At the very least, the better strategy is simply to hold to the status quo *ante*, so that at most $10 million in assets are at risk in the case. Yet, even that outcome will not represent the final resting place. One possible way to defeat all products liability claims against successors is through a piecemeal disposition of the company. Astute corporate owners could decide to sell off bits and pieces of the assets to different buyers, engage in partial liquidations or dividends to current shareholders, and then finally liquidate the rest. Let us assume that net of some very healthy transaction costs, this approach will yield the current crop of shareholders six million dollars. The wide dispersion of assets makes it very difficult for any future party prejudiced by the transaction to locate *the* proper defendant.

The net effect of this relentless strategy of fragmentation is to destroy the going concern value of the business. The current insiders will prefer to liquidate the company, receiving six million in cash in the process, than to sell the company in a way that preserves going concern value and costs the shareholders two million dollars to purchase additional insurance coverage.[53] So long as the complex liquidation options are available to the seller as a fallback position, the channeling rationale will not work if the costs of insurance to the corporate seller are greater than the costs of dismembering the corporation. Adopting the channeling rationale will lead to the result that no one will be covered, given the liquidation. A rule that insulates the successor from liability ought in principle to be preferred to one that does not. Either way the tort claimants get nothing. In some cases, a residual risk might remain but it is likely to be small if the transaction complied with all applicable state formalities and the relatively short time for creditor claims against shareholders had passed.[54] In contrast, removing successor liability at least preserves the going concern value of the business.

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749 (1985).

53. PRODUCTS LIABILITY RESTATEMENT, *supra* note 11, § 12, cmt. b.

54. Michael D. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17, 18-20 (1986) (noting that the traditional law of fraudulent conveyances was not directed to long-term risks).

IX. LIQUIDATION INSURANCE

The overall result is far less than ideal, for nothing commends an outcome in which liquidation puts an effective end to tort liability that should otherwise be imposed. In effect, the corporate form creates a valuable option to the shareholders of the venture. Keep the business alive if the prospects are good; terminate it if the prospects are bad. A "heads I win, tails you lose" approach always marks a conflict between private and social welfare.

This unfortunate turn of events could be avoided if the liquidation option were made as costly as the sale option. One possibility to achieve this result has been proposed by Professor Michael Green. His idea is to dispense with successor liability altogether but to require firms to acquire an appropriate level of insurance in order to go out of business, be it by asset sale or liquidation.[55] The point is that the insurance cover will remain even after the firm disappears. Therefore, as a first approximation, the owners of the predecessor corporation have no incentive to dismember the corporation to escape liability. The insurance has to be purchased on liquidation or sale, so the "astute corporate owners" have no incentive to liquidate the corporation piecemeal. The result still requires one small adjustment. Liquidation insurance that covers only the net worth of the ongoing company will be cheaper by two million dollars than a sale in which the buyer requires the seller to insure for the full extent of its own loss. That lack of parity could be eliminated if the liability of the successor corporation were only equal to the potential liability of its predecessor. Now the perverse incentive to liquidate could be removed and the risk of successor liability averted. The great advantage of this system is that it makes sure that none of the liabilities of past companies are pushed forward against successor corporations who themselves have done nothing in the manufacture or sale of the product to merit the imposition of liability.[56]

Professor Green's scheme seeks to impose this plan on all products, broadly defined, and backs up the system with personal liability on the officers and directors who authorize the dissolution of the corporation without tending to the insurance.[57] To my knowledge, this system has not been implemented, and the explanation for the current lack of inertia doubtlessly lies in the troublesome details on its execution; this kind of insurance is deceptively difficult to arrange. Something of the sort has been sold in medical and other professional malpractice markets, where the insurance contract covers all occurrences within the policy period, even if the claims are made long afterwards. But these policies are tricky to finance because they require either a substantial front end premium or annual premiums for the duration of the long tail. They present formidable questions of administration, for what should the insurer do if it does not receive the cooperation of the insured when claims are brought during the out years of the policy? Owing to the less effective defense, the potential exposure is likely to be higher than it was

55. *Id.* at 49-59.
56. *Id.* at 53.
57. *Id.* at 50, 53.

when the insured remained in business, so that what is created is, in effect, a windfall to the plaintiff. Therefore, the insurance in question will have to cover this contingency, which leads to the familiar kinds of inefficiency that flow from overdeterrence, that is, from imposing liability in those cases where it should be withheld.

These problems are more acute in the context of products liability because which firms should be required to take out the long-tail insurance and in what amounts is often unclear. Many firms that are involved in sale or liquidation clearly have little or no products liability exposures, and requiring them to enter into expensive transactions to respond to a nonexistent risk, which is what happens under a very broad definition of products liability, would seem a pointless impediment to their liquidation or sale.[58] Requiring them to retain some shadow insurance presence for a long period of time in order to respond to the claims that in all likelihood would never be brought would be equally awkward. In addition, it would be somewhat odd if the insurance coverage extended only to their products liability claims, as opposed to other types of exposures, such as the highly variable environmental risks under CERCLA.[59]

Let us suppose then, that the predecessor cannot or should not take out this form of products liability insurance. The usual argument in favor of allowing the broader successor liability is that most claims are small and predictable so that insurance in a ready market is available to deal with the risks in question. So why worry?[60] Once again the selection factors take place. Looking at this corner of the law by examining the behavior of those companies that have been bought out under the current rules that allow for some form of successor liability makes little sense. The key question is whether this purchase will take place in the first place. Professor Cupp is aware of the point when he notes that the traditional objection to an expanded form of successor liability involves, as urged by Professor Michael Green, the implicit limitations on the alienability of the assets or shares of the predecessor corporation.[61] But Cupp misses the correlative point, which is that long-lived claims are likely to have greater severity than those brought in the short term.[62] The key variable is not the average size of products liability claims, or even the average size of the claims brought against the predecessor corporation. The questions here are the expected costs of that subset of claims that will be brought against the successor in title and the ability to anticipate them *ex ante*.

In some cases, a corporate buyer will have some ability to estimate this long tail of the initial exposure, but in many cases a buyer cannot, at least if history is any guide. For example, the cases involving suits against the lead pigment

58. As in Professor Green's statute. *See id.* at 50.

59. Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601-9675 (1994). *See* Cupp, *supra* note 42, at 864-68.

60. *See* Cupp, *supra* note 42 at 870-72.

61. *See id.* at 868. These limitations are discussed at length in Green, *supra* note 54, at 25.

62. *See* Green, *supra* note 54, at 19 n.11 (citing INSURANCE SERVICES OFFICE, PRODUCT LIABILITY CLOSED CLAIM SURVEY: A TECHNICAL ANALYSIS OF SURVEY RESULTS 81 (1977)).

manufacturers attack sales made in the 1930s,[63] many of the asbestos claims date from the shipyards operations in the 1940s,[64]and some DES claims date from the 1950s.[65] The one point that is clear about each and every one of these transactions is that neither buyers nor sellers of such businesses had any awareness of the implicit products liability risk at the time these early corporate transactions took place. The law needed to create the liability had not yet existed. For example, *Borel v. Fiberboard*[66] inaugurated the endless set of asbestos cases, but came literally without warning as a bolt from the blue. Therefore, the crucial question is not about the routine transaction in which the amounts at stake are small relative to the size of the transaction. The crucial question concerns the tiny fraction of cases that generates the huge portion of the litigation against the successor corporations, and for those transactions information about industry averages is of little consolation at all.

In response, some may contend that the age of surprises is over—products liability law has been stable for a couple of decades now, and, going forward, the claims estimation process should be a lot more precise than it has been to date. Once again the point is subject to dispute, for the frequency and severity of asbestos claims, often against second-tier defendants, has only increased in recent years to the point where it has placed major stresses on both liability and insurance systems. Much the same could be said about the liability that gun manufacturers may yet come to bear on public nuisance theories that would have been regarded as untenable only a short while ago. The key point here is that the current law may be stable in the sense that new doctrines will not evolve out of whole cloth, but older rules may be applied to new circumstances or established products could easily generate novel risks. It does not take many claims to create a new cottage industry—the behavior at the tail matters, not that at the middle of the distribution.

X. CLOSING THOUGHTS

What should be done? The short answer is very little. The initial imperfection is brought into the system by creating limited liability, a rule that improves the prospects of recovery in some, but not all, cases. The cases that crop up in litigation are those in which the assets of the predecessor are not sufficient to meet the liabilities of its activities. In general, the status quo *ante* is the right rule, which the Third Restatement follows, with however, the important, if mistaken, exception that exposes the assets of the successor corporation in cases of mergers and acquisitions unless some care is taken to structure those transactions to avoid that risk. The overall lesson, one that Gary Schwartz well understood, is that grin and bear it is

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63. *See, e.g.*, Santiago v. Sherman Williams Co., 3 F.3d 546 (1st Cir. 1993) (rejecting market share liability in lead pigment products liability case involving walls painted in the 1930s).

64. *See, e.g.*, Hamilton v. Asbestos Corp., 95 Cal. Rptr. 2d 701 (Cal. 2000) (concerning asbestos exposure beginning in the 1940s).

65. *See, e.g.*, *In re* DES Cases, 789 F. Supp. 552, 558 (E.D.N.Y. 1992) ("Millions of pregnant women ingested DES during the 1950s and 1960s.").

66. 493 F.2d 1076 (5th Cir. 1973)

sometimes the best solution. Our institutions are always imperfect. We are tempted to assume that shiny new proposals that are not battle tested will do better than rules that have survived the scars of judicial combat. Sometimes that result is true, but in this case, the law of successor liability, subject to the caveat mentioned, looks efficient in that second-best sense of the best of a flawed set of alternatives.